With the accelerating globalization of economic relations and the compression of travel and communication distances between countries, increasing numbers of U.S. citizens and residents find themselves holding property in jurisdictions outside the United States, while many foreigners increasingly have U.S. family members or hold property here. Planning for clients with multi-jurisdictional connections is often very complex. It helps, therefore, to keep these 10 essential principles in mind:

(i) All citizens of the United States and many U.S. residents are subject to U.S. federal transfer taxes on their worldwide assets. Alone among the major industrialized countries of the world, the United States imposes its worldwide income tax and its worldwide transfer taxes (gift, estate and generation skipping transfer) on the basis of citizenship, regardless of residence, domicile or other circumstances. This applies equally to real and tangible property, as well as all forms of intangible property interests. The situation is more complex with people who are legal permanent residents of the United States or who otherwise become U.S. income tax residents. But in many cases non-citizens who live for a sustained period of time in the United States become subject to U.S. worldwide transfer taxes in the same manner as U.S. citizens.
Neither permanent resident status nor meeting the physical presence test for U.S. income tax residence *ipso facto* makes a person a U.S. resident for transfer tax purposes. Here, the test is domicile, for which spending time somewhere in the United States must be matched by having “no definite present intention of later removing therefrom.” Legal permanent residence is clearly of probative value for this analysis, but permanent resident status, especially for those who qualify on the basis of employment rather than family relations, may not preclude a continuing intent to return to a home maintained abroad.

(2) Foreign persons may make unlimited gifts of U.S. financial assets (other than cash) completely free of U.S. federal gift and generation-skipping transfer taxes. Foreign persons (those who are neither U.S. citizens nor domiciliaries) have the benefit of what is perhaps the biggest authorized tax loophole in the U.S. transfer tax system: Gifts they make of all U.S. assets other than real and tangible property located in the United States are completely free of federal gift tax. Care should be taken, however, when a foreign person makes gifts of cash: They are well advised to make gifts of cash from bank accounts located outside the United States, because the Internal Revenue Service considers gifts of cash from a U.S. bank account to be gifts of U.S. tangible property subject to gift tax. In addition, even when a foreign person makes gifts of cash from a foreign bank account to be used almost instantaneously to purchase U.S. real or tangible property, the IRS may argue that these gifts are really gifts of the purchased property and therefore subject to federal gift tax.

The virtual exemption from U.S. gift tax on transfers of intangible assets by foreign persons is a powerful planning tool in two particular contexts: First, it should be possible for a foreign person who directly owns substantial U.S. investment assets (with the possible exception of real and tangible property) to organize that person’s property to avoid U.S. estate tax upon that person’s death with virtually no tax. Second, a foreign person with substantial U.S. or foreign assets who has family and friends in the United States whom the foreign person wishes to benefit can provide for those U.S. individuals during their lifetimes with no U.S. transfer tax. By contributing intangible U.S. or foreign assets to a dynasty trust for the benefit of U.S. beneficiaries, the property can be available to the families of U.S. beneficiaries for generations to come, while being completely insulated from federal gift, estate and generation skipping transfer taxes.

(3) Estates of non-U.S. persons are subject to federal estate and gift tax only on U.S. property they directly own, not on property they own through foreign corporations. Estates of foreign persons who die owning U.S. assets are subject to U.S. estate tax on these U.S. assets, but with a greatly diminished estate tax unified credit conferring an effective estate tax exemption of only $60,000. But foreign persons enjoy an exemption on proceeds of life insurance on the life of a foreign decedent, almost all U.S. bank deposits and accounts and on virtually all U.S. debt instruments issued since July 1984.

Foreign persons (other than certain former U.S. citizens), however, have an almost breathtakingly simple way of protecting all of their assets from federal estate taxation by acquiring U.S. assets through non-U.S. corporations. If an entity the United States recognizes as a foreign corporation acquires U.S. assets (that is to say intangible, tangible or real property located in the United States), the United States generally does not look through that entity to determine whether the underlying assets are U.S. assets. In many cases, however, trusts in which a foreign individual retains an interest or control do not generally function in this protective way because, under long-established statutory rules, U.S. assets belonging to such trusts are treated as if the foreign grantor owned them directly.

Nevertheless, the estate tax benefit of using a foreign corporation to shelter assets from U.S. estate tax must always be weighed against possible unwanted tax consequences, such as branch profits tax liability and capital gains tax liabilities at higher rates than if the foreign shareholder or a trust owned the assets directly. Therefore, a complete income and transfer tax analysis should be conducted to ensure the most tax-efficient approach is adopted, which results in a net benefit for the client and the client’s heirs.

(4) Gifts and bequests to non-U.S. citizen spouses that are subject to federal transfer taxes are not eligible for the gift and estate tax marital deductions. The unlimited gift tax marital deduction is not available for gifts to non-citizen spouses. As a partial offset, the annual gift tax exclusion for gifts to a non-citizen spouse is increased tenfold (in 2006, from $120,000 to $1,200,000), with adjustments for inflation. This expanded exclusion provides protection against the unintended gift tax liability a U.S. person could incur when acquiring or titling property jointly with a non-citizen spouse who does not contribute to the acquisition, as long as the total value of the property does not exceed twice the expanded annual exclusion. A gift in trust for the benefit of the non-citizen spouse and other family members could be protected from gift tax by giving the non-citizen spouse a Crummey power of withdrawal equal to the expanded annual exclusion.

Assuming there is no pre-conceived
Virtually every jurisdiction in the United States uses a relatively simple rule to determine which laws will generally govern property in a decedent’s estate.

That rule says the law of the situs of real property governs all legal issues concerning any such real property, including land that makes up the property, as well as any physical building or other structures that cannot be easily removed from that land. The rule also says the law of the domicile of the decedent generally governs all other forms of the decedent’s property, which is often referred to as “personal property” and includes (1) tangible property other than real property, as well as (2) all financial assets, claims and legal rights, often referred to as “intangible property.”

The distinction between real and personal property can be important in determining governing law in most common law countries. Take, for example, a New York domiciliary decedent who acquired a vacation home in Arizona during his second marriage. The decedent’s will leaves the Arizona home to his only child from his first marriage. But Arizona law would most likely govern the surviving spouse’s rights with respect to the Arizona real property. Because Arizona is a community property state and the home in Arizona was acquired during the second marriage, the surviving spouse may well be able to claim a one-half undivided share in the Arizona home on the basis that the real property was property of the marital community—regardless of the provisions in the decedent’s will.

Civil law distinguishes between “immovable” and “moveable” property. Generally, immovable property consists not only of land and permanent structures connected to it, but also leaseholds, mortgages and other claims or rights closely related to real estate. Moveable property generally consists of all other forms of property, including financial assets other than those closely tied to real property. Take a U.S. citizen client domiciled in New York who owns a mortgage on real property located in France. What law will govern the inheritance of the mortgage? France will apply French law to immovable property located in France and apply domiciliary law to that person’s moveable property. Because the mortgage is considered under French law to be immovable property, French law would likely govern.

But many civil law countries do not make any distinction between types of property for purposes of determining governing law and they determine governing law, in the estate context, on the basis of nationality. When the country of nationality has a federal system, the governing law would be determined on the basis of the decedent’s domicile or “place of closest connection.” This appears to be a much simpler and straightforward approach than the usual U.S. approach. Thus, for example, a U.S. citizen who has lived in New York for many years and owns real property in Germany could have assumed that German officials would apply New York law to the inheritance of the property.

Unfortunately a number of civil law countries, including Germany, have adopted a more complicated approach to applying the law of nationality. The principle of nationality remains unchanged. But now the reference to the law of nationality is not only to the property and inheritance laws of the country of nationality, but also to the “choice of law” rules of that country as well. So, in our example, a German court would more likely look first to the choice of law rules of New York before looking to the substantive New York rules. Therefore, because, under New York law, the law that applies to real property is the law of the situs or location of the property, a German court today may well apply German law to the inheritance of German real property owned by a New York decedent.

—Michael W. Galligan

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Endnote
1. For a general discussion, see Jeffrey A. Schoenblum, Multistate and Multinational Estate Planning, Sections 9.09-9.10 and 15.06 (1999 and 2000 Supp.).
plan or arrangement, a non-citizen spouse who is domiciled in the United States could transfer property gifted under the expanded annual exclusion either to a revocable or irrevocable trust, reserving for the non-citizen spouse a beneficial interest during life, with the remainder passing upon the non-citizen spouse’s death to a qualified terminable interest property trust (QTIP) trust for the benefit of the U.S. spouse if the non-citizen spouse predeceases the U.S. spouse.

While the unlimited estate tax marital deduction is not available for transfers made upon death to a non-U.S. citizen surviving spouse, a marital deduction is available if the recipient of a bequest upon death is a qualified domestic trust (QDOT) for the non-citizen spouse’s benefit or if bequests upon death to the spouse are redirected by the surviving spouse to one or more post-mortem QDOTs within the statutory election period after the predeceased spouse’s death. The most significant practical difference between a QDOT and a QTIP trust is that distributions of QDOT principal to the surviving spouse are generally subject to additional estate tax payable on April 15 of the subsequent calendar year. Principal distributions from a QTIP trust, on the other hand, are not subject to estate tax at the time of the distribution and incur no estate tax upon the donee spouse’s death if the property has been consumed or given away in the meantime. To maximize the amount payable to a non-citizen spouse as income from a QDOT (in most cases incurring income tax for the surviving spouse but no additional estate tax), a trustee may seek to hold as many assets that produce as high an amount of accounting income, such as interest or dividends, as the applicable state law prudent investor or prudent person rule will allow. If the yield on the trust’s investments is low, the trustee should be able to invoke any applicable state law rule permitting the trustee to adjust the payout to the current non-citizen spouse beneficiary by making a supplementary distribution of principal or even a unitrust election, at least assuming the payout fits within the IRS’s three percent to five percent safe harbor income allocation for unitrusts.

(5) Direct contributions by U.S. individuals to foreign charities are generally eligible for the federal gift and estate tax charitable deductions, even though they are not eligible for the federal income tax charitable deduction. Estates of non-U.S. persons should be subject to federal estate and gift tax only on U.S. property they directly own, but not on property they own through foreign corporations.

The United States imposes special tax regimes and reporting requirements on U.S. persons who own foreign assets through foreign corporations, partnerships and trusts. The United States discourages U.S. persons from holding assets abroad through foreign entities by often accelerating taxes or imposing tax penalties on income generated by foreign entities and by requiring extensive reporting about the entities and their holdings. Perhaps best known in this connection are the taxes the United States imposes on the Subpart F income of a controlled foreign corporation and the interest charge on so-called “excess distributions” from passive foreign investment companies. The obligation to pay the accelerated taxes in the case of a controlled foreign corporation, is supported by requiring a U.S. shareholder to make an annual information return on Form 5472. U.S. owners of interests in foreign partnerships under ownership tests similar to those for controlled foreign corporations are required to make an information return on Form 8865.

Congress has similarly enlarged and extended the reporting requirements for U.S. grantors and beneficiaries of foreign trusts. The U.S. grantor of a foreign trust must make an information return on Form 3520.
When the U.S. person is treated as the owner of the trust property because the trust has U.S. beneficiaries, the grantor also must file an annual information return on Form 3520A and report the income and gains of the trust on Form 1040. U.S. beneficiaries of foreign trusts who receive distributions from foreign trusts also must make a return on Form 3520. When there are distributions of accumulated income from prior years, beneficiaries also must pay the “throwback” tax and interest charge in addition to the income they would otherwise report on Form 1040. Moreover, U.S. persons who receive gifts from persons abroad must report the receipt of gifts from a foreign individual or estate exceeding $100,000 on Form 3520, even though no tax is owed. The presumptive purpose for this requirement is to give the IRS the opportunity to investigate whether such gifts should be re-characterized as distributions from foreign trusts or corporations on which a tax is due.

The penalties for failing to file Forms 5471, 8865, 3520 and 3520A are generally punitive; the costs of preparing the returns and the risks of even accidental noncompliance must be carefully taken into account when devising an estate plan for a U.S. person with non-U.S. assets.

(7) Trusts can very easily become foreign trusts for U.S. federal income tax purposes, with substantial disadvantages for U.S. grantors and beneficiaries.

Whether a trust is foreign or domestic for U.S. income tax purposes is of paramount importance: Foreign trusts are generally nonresident alien individual taxpayers and therefore exempt from gains tax on the sale of U.S. assets (other than U.S. real property interests) and withholding tax on interest from portfolio debt and bank accounts. U.S. tax rules, however, deprive most U.S. persons of benefiting from the generous treatment given to foreign trusts and often penalize them for establishing foreign trusts or benefiting from them.

To be a U.S. trust, a trust must be (1) subject to the primary supervision of a U.S. court (the “court test”), and (2) U.S. persons alone must exercise control over all substantial decisions affecting the trust (the “control test.”) To meet the test of primary supervision over a trust, a U.S. court must have the authority to determine substantially all issues regarding the administration of the trust. Primary supervision, however, does not mean exclusive jurisdiction, with the result that a trust with a foreign corporate trustee and two U.S. individual trustees in a state whose courts assert jurisdiction based on the residence of trustees might still qualify as a U.S. trust for U.S. income tax purposes, while also being treated as a trust of the foreign jurisdiction for other purposes.

The control test is a trap for the unwary, because the range of decisions that must be subject to the control of U.S. persons (basically, U.S. citizens, U.S. tax residents, U.S. corporations and other U.S. business entities) includes not only decisions made by formally designated trustees and trust protectors, but also by anyone else who has a power over the trust. Such powers include the power to appoint trust property (whether general or limited), to remove trustees or to appoint successor trustees, and, in some cases, to make investment decisions. Thus, for example, if a U.S. person establishes a lifetime domestic trust for the exclusive benefit of U.S. persons, but gives a Canadian relative the unrestricted authority to appoint a successor trustee, the trust would be a foreign trust for U.S. income tax purposes and these consequences would follow: (i) the trust would become a grantor trust with the U.S. grantor treated as the owner of the trust property and taxed during the grantor’s lifetime as if the grantor still owned it; (2) if the grantor died and the assets of the trust were not eligible for a step-up in basis, gains tax would be due on the unrealized appreciation of the trust’s assets; and (3) if the trust were not repatriated (by ending the unrestricted authority of the Canadian relative), the U.S. beneficiaries would be subject to the throwback tax on deferred distributions of income earned after the trust became a non-grantor trust, with capital gains for this purpose being converted to ordinary income and the imposition of an interest charge on the tax at the tax underpayment rate.

(8) U.S. persons living abroad or owning property abroad often must contend with “heirship” regimes and property regimes that may be inconsistent with their estate-planning goals.

A standard no-tax will for a U.S. married person with credit-shelter and QTIP (or QDOT) trusts can easily become impossible to implement if the person’s estate includes property abroad or if the person is a U.S. citizen living abroad. This is especially so in civil law countries such as France or Spain where children must receive outright a portion of a deceased parent’s estate, statutory heirs (whether spouse or issue) cannot easily waive inheritance rights, and trusts are often not recognized. To complicate matters further, in many civil law jurisdictions, heirs are assumed to succeed to the liabilities of their decedent on an unlimited personal basis—unless timely legal disavowals are made. Also, spouses, in the absence of an express election of a regime of separate property, are assumed to own property in community. Even in common law jurisdictions such as Australia, England, and Ontario that have broad freedom of testation and recognize trusts, courts have statutory authority...
to modify wills to ensure that those with meritorious claims to support from a decedent are fact share in the decedent’s estate. In some cases, application of the foreign jurisdiction’s choice of law rules may result in U.S. inheritance rules being applied instead of the local rules, but current trends in civil law conflicts principles make this less likely.25

Whether the existence of foreign property also requires the execution of a separate testamentary instrument executed under the laws of that country depends in part on whether title to the foreign property can be held in a manner that avoids the application of foreign inheritance rules and foreign taxes. If that cannot be achieved, it seems advisable to execute a testamentary instrument disposing of the property in accordance with the formalities and legal concepts of the relevant country. However, it is very important that the U.S. and the foreign testamentary instruments do not overlap in ways that will create inconsistencies regarding the same items of foreign property. Also, the provisions in the foreign instrument should not inadvertently exhaust unified credit exemption, fail to qualify for the U.S. marital deduction, upset equalizing distributions among beneficiaries, or expose the estate or the beneficiaries to double estate tax.

(g) A U.S. citizen domiciled in a foreign country with estate or inheritance taxes may be subject to double transfer taxation—unless that person lives in, or owns property in a jurisdiction with, a favorable U.S. transfer tax treaty.

Many foreign jurisdictions impose some sort of transfer tax on gifts. These include most jurisdictions in Europe as well as Bolivia, Brazil, Chile, Mexico, New Zealand, South Africa, Turkey and Venezuela. Canada imposes a deemed gains tax on certain gifts. India recently introduced a supplemental income tax on the receipt of gifts. Unfortunately, there is no federal credit for foreign gift taxes. But relief from double gift taxes may be afforded by estate and gift tax treaties with the United States in the cases of Austria, Denmark, France, Germany, Japan, Sweden and the United Kingdom.

All of these countries (except New Zealand) and some others (for example, Iran and Syria) impose some sort of inheritance or transfer tax (in the case of Canada, deemed gains tax). The United States does afford a credit against the federal estate tax for inheritance taxes paid to foreign countries with respect to the foreign property of a U.S. decedent subject to foreign estate or inheritance taxes.25 But the statutory credit is hardly adequate if a foreign jurisdiction taxes the inheritance of property located in the United States when a U.S. citizen decedent owns substantial U.S. assets abroad but dies a resident of that country. That is because the credit extends only to foreign taxes paid on foreign property.25

The United States has estate tax treaties with Austria, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, the Netherlands, Norway, South Africa, Sweden, Switzerland, and the United Kingdom; it also has a protocol to the income tax treaty with Canada. However, only the treaties with Austria, Denmark, France, Germany, the Netherlands, Sweden, the United Kingdom and the Canadian protocol clearly offer concrete credit or equivalent relief when a decedent’s U.S. property is taxed by the non-U.S. treaty country because of domicile or residence and also taxed by the United States because of U.S. citizenship.25 U.S. citizens who reside in countries that have estate taxes but with whom the United States does not have estate tax treaties, such as Belgium, Spain, and the former Eastern bloc countries are subject to a serious risk of double taxation and are especially in need of careful planning.

(10) Most U.S. citizens owning assets outside the United States should consider a U.S. limited liability company (LLC) to hold foreign assets in order to reduce exposure to foreign inheritance law and taxes.

The simplest estate plan for a U.S. citizen or domiciliary who owns property abroad that may be subject to inconvenient foreign inheritance rules or the risk of double transfer taxation is to liquidate any foreign holdings, hold only United States property, live only in the United States and transfer wealth only to U.S. persons. Of course, that is not realistic for many. However, for those U.S. persons who live in the United States, it may be advisable to attempt to create the legal equivalent of owning only U.S. property. This might be done by transferring legal title in foreign property to U.S. entities that foreign countries will not look through to apply their inheritance and property rules or impose their transfer taxes when interests in the U.S. entities are transferred or when the U.S. owner dies. It is critical to review the law of each non-U.S. jurisdiction in which property is located to determine the degree of protection this technique will afford.25 As between trusts, corporations, partnerships and LLCs, the LLC seems to have some significant advantages for this function. The LLC is well known outside the United States, having been adopted in Europe long before it was adopted in the United States. At the same time, an LLC with a single U.S. owner can be disregarded for U.S. income tax purposes.34 If the owner makes gifts of LLC interests to others, the LLC would be taxed as a partnership, thus ensuring the possibility of a step-up in basis for the underlying assets upon a U.S. owner’s death.35 Trusts unfortunately have generally not been incorporated in the internal law of
many civil law countries and only Italy, Luxembourg, and the Netherlands among civil law countries have ratified the Hague Convention on the Recognition of Trusts. Loss of the step-up in basis for assets owned by a domestic corporation is a decided disadvantage for C corporations and is a risk even with S corporations.

Conversely, with a U.S. person who is a resident of a foreign country that does not have a tax treaty with the United States but may tax that person’s U.S. property, it may be advisable to convert the person’s property located outside of that country (whether in the United States or elsewhere) into property located in that country in order to qualify as much of the U.S. person’s property for the federal foreign death tax credit, thus protecting the estate from double taxation. It would appear, however, that a corporation (including for these purposes an LLC that elects to be treated as a corporation for federal income tax purposes) should be used for that purpose, even though potential adverse U.S. income tax consequences may follow and must be planned for, because the corporation is the only entity the IRS currently is known to respect for purposes of determining if property is foreign in the reciprocal situation when a foreign person seeks to transfer U.S. property to foreign entities to protect against the federal estate tax.

COLLABORATE

Competent estate planning with an international edge requires not only a grasp of these 10 principles but also a willingness to grapple with the ways other countries think about inheritance, taxes and property. Effective international estate planning, in the end, has to be a team effort, so never forget to engage competent overseas counsel, because, even if you remember these 10 principles, you can’t expect that you will know—much less remember—the 10 most important estate planning principles in the other jurisdictions with which you must deal.

The author thanks his law firm colleagues Tiberio Schwartz and Jeffrey B. Kolodny and for their assistance with this article.

Endnotes
1. Earlier versions of this article appeared in the Spring 2003 edition of the New York State Bar Association’s International Law Practicum and Annual Notre Dame Estate and Tax Planning Institute, Book II (September 2003).
2. Although the United States has negotiated a range of estate and gift tax treaties with other countries and an even greater array of income tax treaties, it always has been careful to maintain the principle that a U.S. citizen is liable to worldwide U.S. taxation.
4. At any rate, the provisions of Internal Revenue Code Section 877(e) as well as the draconian provisions of IRC Section 877(g) enacted in 2004 appear to assume that any person who has been a legal permanent resident for eight out of the 15 years prior to surrendering permanent resident status has become a domiciliary of the United States for transfer tax purposes as well as a resident for income tax purposes.
5. See IRC Section 2501(a)(2).
6. See Private Letter Ruling 7737063 (June 17, 1977), General Counsel Memorandum 36860 (Sept. 24, 1976), and General Counsel Memorandum 34845 (April 17, 1972).
7. See IRC Section 2104.
8. See IRC Section 2105. Foreign persons who are U.S. income tax residents, however, do not enjoy the exemption on debt instruments. Because brokerage firms do not carry on the banking business, deposits at U.S. brokerage firms are not eligible for the exemption on U.S. bank deposits, see Revenue Ruling 65-245; Ogarrio v. Comm’r, 337 F.2d 108 (D.C. Cir. 1964).
9. See IRC Section 2104(a) and Treas. Reg. Section 20.2104-1(a)(5). Of course, it is important that all corporate formalities (for example, election of directors and officers, annual meetings, maintaining proper books of account for the corporation) are followed. See Fillman v. U.S., 355 F.2d 632 (Ct. Cl. 1966). It is generally preferable that a shareholder execute a lease before using corporate assets. See IRC Section 2107(b) for the exception that applies to certain former U.S. citizens.
10. See IRC Section 2104(b). The capitalization of a foreign corporation with U.S. assets in exchange for shares in that foreign corporation should not be subject to Section 2104(b) because of the bona fide sale for adequate and full consideration in money or money’s worth exception in IRC Section 2036(a). Whether a partnership or a LLC that is taxed as a partnership can be used for this purpose continues to be uncertain.
11. See IRC Section 2523(i).
12. See IRC Section 2523(i) and Revenue Procedure 2004-71 (Nov. 19, 2004).
13. Outside the context of life insurance, of course, the use of so-called “hanging” powers of withdrawal may be less effective to avoid taxable releases or eventual estate tax inclusion upon the death of the surviving spouse.
14. A QDOT election can be filed up to one year after the due date for filing the decedent’s estate tax return, including extensions (that is to say, 27 months after the date of death assuming an extension is timely filed or 21 months after the date of death if an extension is not timely filed, see PLR 9843030 (Oct. 23, 1998)). For a more complete discussion of QDOTs, their uses and requirements, see the expanded discussion in Galligan, supra note 1, at pp. 16A-2 to 16A-5, which appears at www.phillipsheimer.com/publications/articles/10ImportPointsMGUpdate05_art. cfm.
16. If a foreign person makes a charitable gift of tangible or real property located in the United States, the charitable deduction is limited to transfers to U.S. corporate charities or trusts (whether domestic or foreign) that are operated exclusively for charitable purposes that use such gifts within the United States for charitable purposes, see IRC Section 2522(b)(2) and (3). If a foreign person

This more liberal rule has even been extended to bequests to foreign governments as long as the bequests must be used for exclusively charitable purposes. See Galligan, supra note 17, at pp. 156-157.

See IRC Section 642(c) and Galligan, supra note 17 at p. 160.

A controlled foreign corporation is a foreign corporation where more than 50 percent of (i) the total combined voting power of all classes of stock or (2) the total value of the stock of such corporation is owned or considered to be owned (based on the constructive ownership rules of IRC Section 958(b)) by U.S. persons each of whom owns or is considered to own (based on the constructive ownership rules of IRC Section 958(b)) 10 percent or more of the total combined voting power of all classes of stock of such foreign corporation.

A passive foreign investment company generally means a foreign corporation where (1) 75 percent or more of the gross income of such corporation for the taxable year is passive income or (2) the average percentage of assets held by such corporation during the taxable year that produce passive income or are held for the production of passive income is at least 50 percent.

Gifts from related foreign individuals and estates must be aggregated when determining whether this $100,000 threshold has been met. For these purposes, a related person generally includes any person who is related for purposes of IRC Sections 267 and 707(b). Consequently, there would be no reporting requirement if two $90,000 gifts were received from unrelated foreign individuals.

See IRC Section 770(a)(30)(E).

To maintain domestic status if the authority of the Canadian relative were limited to appointing a trustee whose appointment would not cause the trust to become a foreign trust.

See IRC Section 684 and Treas. Reg. Section 1.684-3.


Some civil law countries (for example, Germany, Italy and Spain) apply the same choice of law rule to real property and intangible property and consider the law of a decedent’s nationality as governing law. There is a trend in continental jurisprudence, however, to apply the nationality rule to the “whole law” of a decedent’s nationality with the result that the national jurisdiction may refer back to the law of the country where the property was located or the law of the decedent’s domicile. See “Which Laws Apply?” at p. 51.

See IRC Section 2014.


It is possible in some jurisdictions that the technique will give protection from local property law issues, but not local taxes.

See Treas. Reg. Section 301.7701-2(o)(2)(ii). In some cases, to achieve the desired insulation from a foreign country’s inheritance rules or tax, it may be necessary that the LLC effectively elect to be treated as a corporation for the foreign country’s purposes. This should not necessarily prevent the LLC from being disregarded for U.S. tax purposes.


I’ve been advised that the steps leading to Switzerland’s ratification should be completed by late 2006.

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